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Before the
Federal Communications Commission
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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In the Matter of	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

TO: The Commission

COMMENTS OF THE NATIONAL ASSOCIATION OF BROADCASTERS

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January 27, 1993

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Table of Contents

SUMMARY

Congress has mandated that the rates charged for the basic tier by cable operators be "reasonable," and the Commission must conclude that Congress did not view current cable prices, that reflect the exercise of monopoly power by cable operators, as meeting that test. Rate regulations which merely ratify current prices for all but a few cable systems would not, therefore, appear to be in line with the Commission's duty under the Act.

With respect to the basic tier of services, Congress has asked the Commission to develop a rate regulation scheme that: 1) will extract the monopoly rents currently included in most cable rates; 2) will not unduly inhibit or reduce cable incentives to provide diverse quality programming; and 3) is relatively easy to administer. NAB has provided herein a rate regulation model for the basic tier that would extract the best, and eliminate the most undesirable elements of the various suggested approaches to achieve that which Congress intended.

NAB's proposal would combine cost benchmarking using estimated *replacement* capital costs for cable systems of different sizes and types, attributable to the basic tier, with an individualized assessment of each cable system's actual variable or non-capital costs for basic service to arrive at a "reasonable" rate for the basic tier. Implementation of this proposal could result in providing a 16 channel (out of a total 40 channel system) basic tier costing, on average, $4.52 according to preliminary estimates.

In what ever scheme that is adopted for regulating basic tier rates, retransmission consent costs should be treated no differently than those of cable programming services. In applying the principle to the adoption of any rate-based benchmark approach, rates used to establish such benchmarks must be discounted for the value which cable already receives for the retransmission of broadcast signals but which, heretofore, it has not been required to convey to the owners of those signals.

The Act requires that the basic tier include "any signals of any television station" carried by a cable system except for superstations. There is no basis for exempting from carriage on the basic tier distant stations or those opting for retransmission consent. Moreover, the Act precludes à la carte offerings that could be purchased without subscribing to the basic tier.

To qualify as a multichannel video programming distributor deemed to provide effective competition to an existing cable system, a video service must offer programming comparable to all video services offered by the cable system, not just that provided on the basic tier. Television stations which might, in the future, provide limited multichannel services would not qualify under this standard.

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COMMENTS OF THE NATIONAL ASSOCIATION OF BROADCASTERS

The National Association of Broadcasters ("NAB")[1/] submits these comments on the Commission's *Notice of Proposed Rule Making* ("*Notice*"), in the above-referenced proceeding.

Introduction

The rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("The Act") present the Commission with a daunting task — putting into place a comprehensive rate regulation mechanism governing thousands of cable systems and enforceable by thousands of local governments. More

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1/ NAB is a nonprofit, incorporated association of radio and television stations and networks which serves and represents the American broadcast industry.

than other portions of the Act,[2] the rate regulation sections grant wide discretion to the Commission to determine the best ways to achieve Congress' objectives. In many parts of the revised section 623 of the Communications Act, Congress identified factors which the Commission should consider in developing rate regulations, but left to the Commission the ultimate decision as to which of these factors should be included in the formula used to control cable rates and the relative weight to be given each of them.

Given the very short time frame in which the Commission must act, the Commission should focus on the central purpose of establishing a basic mechanism for cable rate determinations. It must not become bogged down in an endless series of "what if" scenarios, or attempt to deal with every issue that might be presented in the course of setting rates for a particular system. It is enough that the Commission establish a workable mechanism that it believes can effectively contain cable rates. Section 623(k) directs the Commission annually to publish cable pricing data. This requirement demonstrates that Congress did not view the Commission's role in rate regulation as static; instead, the Commission should monitor how its approach is working in practice and make adjustments as they are needed.

While the Commission can make adjustments to its rate regulations in the light of experience, its initial regulations must be designed to achieve Congress' fundamental goals. In the Cable Act, Congress found that the current cable marketplace has

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[2] *See, e.g.,* Sections 614, 615 and revised Section 325 of the Act which grant to the Commission considerably less discretion with respect to implementing regulations.

resulted in "undue market power for the cable operator." Cable Act § 2(a)(2). Congress concluded that cable rates have increased unreasonably since local rate regulation ended in 1986 and, therefore, that cable rates reflected the exercise of monopoly power by cable operators. Congress mandated that the rates charged for the basic tier by cable operators be "reasonable," and the Commission must conclude that Congress did not view current cable prices as meeting that test. There is nothing in the legislative history of the Act which indicates that Congress was exclusively concerned with future increases.

Rate regulations which merely ratify current prices for all but a few cable systems would not, therefore, appear to be in line with the Commission's duty under the Act. Similarly, the Commission cannot assume that any increases in cable systems' costs can result in corresponding increases in cable rates if the Commission is to comply with the requirement that basic service rates be "reasonable." While the Commission may properly consider whether a particular rate regulation structure might have unintentionally harsh effects on some cable operators, concerns about the fit between the rate regulations and their practical impact must be symmetrical. Thus, while the Commission proposes in the *Notice* (*e.g.* ¶¶ 33, 34) that cable operators be permitted to adduce cost data to demonstrate that a benchmark is inappropriately applied to particular systems, the Commission does not propose that franchise authorities or consumers should be afforded the parallel opportunity to demonstrate that a cable system's costs are well below those which were assumed in setting the benchmark. The Commission does not attempt to explain this apparent inconsistency.

In developing a regulatory framework, the Commission should also keep in mind the need that rate regulations be relatively easy to administer, and thus should avoid a structure which requires detailed individualized decisionmaking for every cable system. Moreover, by requiring in section 623(h) regulations to prevent evasions of rate regulation by retiering or other means, Congress expressed a preference for a regulatory structure which will minimize incentives for "gaming" the rate regulation rules, such as the creation of undesirable basic tiers or substituting cheap and unpopular cable programming for quality cable programming, or the use of rate increases for MSO-owned cable program services to circumvent rate controls.

NAB will address in these comments a number of the questions raised in the *Notice* about regulation of the basic service tier required by the Act. In particular, we will discuss how the Commission should deal with the impact of retransmission rates on the price charged for cable service. NAB is submitting a study of the rate regulation alternatives available to the Commission prepared by Strategic Policy Research, Inc., along with a recommended approach that will result in meaningful control over basic service rates, diminish incentives to manipulate the rate regulation mechanism, and will not present insurmountable enforcement difficulties.

Retransmission Consent

The Commission (*Notice* ¶ 31 n.60) asks for comments on what, if any, separate consideration it should give to costs incurred by cable systems to obtain retransmission consent from broadcast stations. As the Commission notes, under section 325(b)(3)(A) of the Act, the Commission must ensure that payments for retransmission consent do not result in unreasonable rates for basic service. The Commission concludes that this obligation does not require it to provide any particular regulatory treatment for retransmission consent costs, and instead may treat retransmission consent payments in the same way it provides for similar types of costs incurred by cable systems. This approach is consistent with section 623(b)(2)(C)(ii) which suggests that the "direct costs" of obtaining the signals carried on a cable system's basic tier should be considered in establishing a reasonable rate for that service.

Under this approach, the costs of retransmission consent would be viewed as functionally identical to the direct costs of cable program services carried on a system's basic tier. NAB believes that this reflects the intent of Congress. The Act certainly does not permit the Commission to establish a mechanism to govern the amounts which cable systems pay for retransmission consent which does not accord similar treatment to payments for cable programming. The Senate Commerce Committee explained that under its retransmission consent provision, which was adopted by the conference committee, "[i]t is the Committee's intention to establish a marketplace for the disposition of the rights to retransmit broadcast signals; it is not the Committee's intention to dictate the outcome of the ensuing marketplace negotiations."[3/] Singling out retransmission consent payments from other program expenses

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3/ S. REP. No. 92, 102d Cong., 1st Sess. 36 (1991)[hereinafter *Senate Report*]. S. 12, as passed by the Senate, also directed the Commission to "consider . . . the impact the grant of retransmission consent by television stations may have on the rates for basic cable service and shall ensure that rates for basic cable service are reasonable." S. 12, 102d Cong., 2d Sess. § 15 (1992).

incurred by cable systems would not be consonant with the marketplace approach adopted by Congress in section 325.[4]

Precisely how retransmission consent payments should be accounted for in a rate regulation system depends, however, on the regulatory structure the Commission adopts. If the Commission selects a cost-based benchmark approach under which the permissible rate is established by the actual costs which a cable system incurs or is presumed to incur, then the costs of retransmission consent would be included with other direct programming expenditures.

On the other hand, if the Commission selects a rate-based benchmark under which allowable rates are based on rates charged by other cable systems either now or in the past, the Commission should not automatically assume that the costs of retransmission consent should be reflected in an increase in the allowable price of the basic tier. Congress found that:

> "Cable systems . . . obtain great benefits from local broadcast signals which, until now, they have been able to obtain without the consent of the broadcaster . . . This has resulted in an effective subsidy of the development of cable systems by local broadcasters."[5]

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[4] In addition, while retransmission consent fees will be established in marketplace negotiations between independent parties, many of the popular cable programming services are owned by or affiliated with large cable operators. It is far less likely that the rates charged by such vertically integrated companies will accurately reflect the true worth of the service than the prices which may be paid for retransmission consent.

[5] Cable Act § 2(a)(19).

As the Senate Report elaborated, "a very substantial portion of the fees which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals."[6] Congress concluded, therefore, that the rates which cable systems have charged consumers already includes the value of broadcast signals, but that broadcasters currently are not being compensated for that value.

Whether a particular rate is charged by a competitive cable system or a pre-deregulation cable system, the Commission must assume that it incorporates some measure of the value which subscribers derived from retransmitted broadcast signals. Thus, any amounts which the cable system must now pay to continue using those signals should not raise the price which consumers pay since that would give the cable operator a double recovery. Only if the benchmark rate first was discounted for the value of retransmitted broadcast signals would it be appropriate for cable systems to be permitted any possible increase in a rate-based benchmark price to take account of retransmission consent costs.

Composition of the Basic Tier

The rate to be set by local franchise officials is for the services provided on a cable system's basic tier.[7] The Cable Act defines what services must be included in

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6/ *Senate Report* at 35.

7/ Cable Act § 623(b)(7). The Act directs the Commission to ensure that unreasonable rates are not charged for other tiers of service. Because, as we discuss below, all non-superstation broadcast stations must be carried on the basic tier, NAB will not address the standards which should be used in considering rates for cable programming services.

the basic tier and establishes that tier as the basic building block of all services provided by the cable operator. In paragraphs 11 and 12 of the *Notice*, the Commission asks for comments on interpretations of the Act which are at odds with the statutory language and the intent of Congress. The Commission should not adopt any of these idiosyncratic interpretations.

Section 623(b)(7) states that "[e]ach cable operator of a cable system shall provide its subscribers a separately available basic service tier *to which subscription is required for access to any other tier of service*." (emphasis added) The services which must be included in that basic tier are (1) all signals carried on the cable system pursuant to section 614 and 615, the must carry requirements, (2) any PEG channels required by the cable system's franchise agreement, and (3) "any signals of any television station that is provided by the cable operator to any subscriber,"[8/] except broadcast signals obtained from a satellite carrier — superstations.

The Commission asks in paragraph 12 of the *Notice* whether this establishes a requirement of a basic tier "buy through," or whether certain services could be offered on an à la carte basis to subscribers who did not purchase the basic tier. The Act forbids cable systems from establishing such sales practices. Section 623 makes clear that subscription to the basic tier is a precondition to delivery of any other service from a cable system. Although section 623(b)(7)(A) states that the basic tier is required to obtain any other *tier* of service, perhaps suggesting that the Act could permit the offering of an individual service or services without the basic tier, section

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[8/] Cable Act § 623(b)(7)(A)(iii).

614(b)(7) of the Act requires that all commercial must carry signals "be provided to every subscriber of a cable system." Section 615(h) mandates that noncommercial must carry signals be included in the same service package as commercial signals, and those signals therefore also must be provided to every subscriber. Since must carry signals are required to be part of the basic service tier, it follows that anyone who subscribes to the cable system for any cable service must subscribe to the basic tier.[9/] Therefore, cable operators cannot, consistent with the Cable Act, provide any cable services on an à la carte basis to customers who do not purchase the basic service tier.

In paragraph 11, the Commission asks whether the amendments to section 325 of the Act to permit broadcast stations to require retransmission consent from cable systems will affect the composition of the basic tier. Although the Commission tentatively concludes that any local signal carried pursuant to a retransmission agreement would be on the basic service tier, it also asks whether a station which had fulfilled its must carry complement under sections 614 and 615 would be required to include in the basic tier other stations carried by the system voluntarily. The Commission's initial conclusion is correct: whether a station is carried under must carry or

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9/ Therefore, the question posed by the Commission in paragraph 9 n.15 of the *Notice* — whether a third-party offering on a cable system using leased or PEG channels could be viewed as a competing multichannel video programming distributor — must be answered, no. Leased access and/or PEG channels can only be provided to subscribers of a cable system who Congress directed must also take the basic service tier. Thus, any independent services offered on a cable system cannot be deemed to compete with it. *See infra* p.p. 11-13.

retransmission consent has no effect on its tier placement. The Act's language could not be plainer — "any signals of any television station" carried by the cable system (apart from superstations) must be provided as part of the system's basic service tier.

To the extent that the Commission intended to suggest in paragraph 11 that only *local* signals must be part of the basic tier, such a distinction also has no support in the Act. Certainly, the term "any television station" cannot be read to include only stations which are local to a cable system. Indeed, had Congress had any such intention, it would have been unnecessary to include the exclusion for superstations which, by definition, are not local.[10/] Thus, whether a station is carried under retransmission consent or must carry, or it is local or not, its signal must be part of a cable system's basic service tier offering.[11/]

10/ Reading the statute otherwise would raise a further question of whether the term "local" would be construed to mean stations which are in the same television market as a cable system, or instead stations which are local for copyright purposes. That this question also finds no answer in the Act suggests that implying a restriction to local stations in section 623(b)(7)(A)(iii) is not consistent with Congress' intent.

11/ In comments filed in MM Dkt. 92-259, Newhouse Broadcasting Co. suggested (Comments at 17-19) that the exemption from the requirement of obtaining retransmission consent for carriage of certain superstations found in section 325(b)(2)(D) should be read to include carriage of the signal of a superstation obtained from a microwave carrier. NAB explained how Newhouse misread the language and intent of the statute which restricts the exemption to signals actually obtained from a satellite carrier. *See* Reply Comments on NAB, MM Dkt. No. 92-259 (filed Jan. 19, 1993) at 42-43. Should a similar suggestion be made in this proceeding, the Commission should conclude that the exclusion in section 623(b)(7)(A)(iii) also applies only to signals which are actually obtained from a satellite carrier.

In paragraph 11, the Commission also requests comment on its conclusion that cable operators may include on the basic tier, in addition to the signals required by section 623(b)(7)(A), any additional services, so long as they are all subject to the basic tier rate regulations. This inquiry is related to the Commission's question in paragraph 32 of the *Notice* concerning whether the Cable Act should be read to mandate a basic tier limited to the signals which are required to be on that tier.

NAB has long maintained that "[i]t is the singular combination of off-the-air channels, distant signals, basic cable networks, and premium channels that establishes cable systems' market power."[12/] If the basic tier offered by a cable system is not attractive to consumers, they may receive little actual benefit from efforts to regulate the rate charged for that tier since all but a few will end up subscribing to other tiers. Thus, while it is clear that Congress intended to promote the availability of basic cable service at low cost,[13/] it would not serve the public interest to prevent cable operators from offering a complement of attractive services on their basic tiers. Indeed, the prohibition in section 623(h) on retiering to evade rate regulation bespeaks a Congressional concern that basic services not necessarily be reduced to their minimum.[14/]

12/ Comments of NAB, MM Dkt. No. 90-4 (filed Feb. 4, 1991) at 2.

13/ *See* H.R. REP. No. 862, 102d Cong., 2d Sess. 63 (1992)[hereinafter *Conference Report*].

14/ *See* H.R. REP. No. 628, 102d Cong., 2d Sess. 82 (1992)[hereinafter *House Report*](Regulations should "encourage cable systems to carry [cable program] services in the basic tier").

NAB, therefore, agrees that the Act permits cable operators to include additional services in their basic service tiers. The rate regulations selected for basic service should not create incentives for cable systems to move desirable services into less regulated tiers since that would tend to defeat Congress' purpose of keeping the overall cost of cable service low. NAB's rate regulation proposal not only avoids such disincentives, but also allows for inducements to keep valuable services in the basic tier. *See infra* p. 20.

Definition of a Multichannel Video Programming Distributor

In paragraph 9 of the *Notice*, the Commission seeks comments on how it should determine whether a video service qualifies as a multichannel video programming distributor competing with a cable system. The Act states that effective competition can only be provided by multichannel video programming distributors which "offer comparable video programming." Section 623(*l*)(1)(B)(i).[15] The Commission asks "whether any minimum amount of programming or minimum number of separate channels must be provided" by a qualifying entity. The Act's requirement certainly imposes upon the Commission the responsibility of determining

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[15] Plainly the term "comparable video programming" refers to all types of video services which are offered by cable systems, and cannot be construed to be limited to basic service tier offerings. Since in other places in section 623 Congress made specific references to the signals of television stations or to cable programming services, the use of the broader term "video programming" was intended to include all types of service offerings. Moreover, were "comparable video programming" construed to mean comparable just to that which was offered on the basic tier, the dominant cable operator in the market would be provided with an incentive to offer a stripped down basic tier as a means of escaping rate regulation.

that an entity said to provide competition for a cable system in fact does so by providing consumers with a similar amount and variety of programming.[16] Although the Act does not require each competing entity to offer the same number or a particular selection of programming, the Commission could not find that an entity offering a handful of channels would offer effective competition to an 80-channel cable system.

Therefore, if television stations begin to offer multichannel services, they should not be considered multichannel video programming distributors for this purpose. Although such television stations would offer more channels than stations do now, they would not approach the variety of services provided by most cable systems. Moreover, if television stations have the capacity to offer multiplexed service, cable systems would also by that point be able to take advantage of signal compression and multiplexing to expand their own capacities. The test must be comparability — subscribers must be able to find a similar variety of services from a competing provider before it can be considered as offering effective competition.

NAB's Suggested Approach to Rate Regulation of the Cable Basic Tier

The Commission's task in implementing the rate regulation provisions of the Act is a formidable one. With respect to the basic tier of services, Congress has asked the Commission to develop a rate regulation scheme that: 1) will extract the

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16/ Indeed, section 628 of the Act was passed to ensure that competitors to cable systems will have access to the programming necessary to provide a true alternative to cable service.

monopoly rents currently included in most cable rates; 2) will not unduly inhibit or reduce cable incentives to provide diverse quality programming; and 3) is relatively easy to administer. Cognizant of the fact that each of the variety of approaches the Commission has suggested in the *Notice* have their advantages and disadvantages, NAB asked the consulting firm of Strategic Policy Research, Inc. ("SPR")[17/] to lend their expertise in developing a rate regulation model for the basic tier that would extract the best, and eliminate the most undesirable elements of the various suggested approaches to achieve that which Congress intended. Attached as Appendix A is the result of SPR's efforts, which includes a hybrid proposal most closely approximating the "Direct Costs of Signals Plus Nominal Contribution to Joint and Common Costs" alternative set forth at Paragraphs 53-56 of the NPRM, but with some significant modifications.

A. Overview of NAB's Proposal and Underlying Rationales

Briefly summarized, NAB's proposal would combine cost benchmarking to estimate fixed capital costs for cable systems of different sizes and types, attributable to the basic tier, with an individualized assessment of each cable system's actual variable or non-capital costs for basic service to arrive at a "reasonable" rate for the basic tier. The Commission would provide a benchmark equation for local municipalities to use to estimate capital costs in their rate determination. By providing this

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17/ The principals in SPR include: John Haring, former Chief Economist and Chief of the Office of Plans and Policy at the FCC; Jeffrey Rohlfs, former Department Head of Economic Modeling Research, Bell Laboratories; and Harry Shooshan, III, former chief counsel and staff director of the House Subcommittee on Communications.

equation for capital costs, the Commission would create a simple method for local municipalities to incorporate these costs when they regulate cable rates. The non-capital costs to include in the basic tier rate determination (e.g., programming costs, customer service costs, etc.) would be easily determined by the local municipality as the local cable system would be required to submit these costs.

Before describing NAB 's proposal in more detail, it is important to understand the reasons for the bifurcated treatment of capital and non-capital costs. First, such treatment provides an efficient method by which municipalities will be able to establish basic tier rates. The more evasive, difficult-to-measure costs of the cable systems, capital costs, will be derived from a benchmark formula that the municipality will find easy to use. In contrast, data for the other area of costs, non-capital costs, will be obtained directly from the local cable system that will be required to show the actual expenses it incurs.

Second, this different treatment for the two types of costs will minimize the quality degradation problem that so often manifests itself in price regulatory schemes. In any rate based and most cost-based benchmark regulatory schemes, the regulated firm will have incentives to reduce the quality of products it offers without any offset to the prices that consumers pay. Under the NAB proposal, there is little incentive to play that game. Degradation of quality through lower capital (fixed) costs, will not occur since these costs by their nature cannot change in the short run.[18] As for the

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[18] There are already few opportunities for a degradation of quality with the Commission's new cable technical rules, buttressed by the amendments to (continued...)

non-capital or variable costs, any attempted reduction in such costs by reducing quality (e.g., fewer or lower quality channels being offered) will not benefit the cable operator, because the cost savings will be realized by consumers in the form of lower basic rates. Hence, cable systems will have little, if any, incentive to degrade the quality of their services.

Moreover, in the long run cable systems, under NAB's proposal, will continue to have incentives to improve their service. By allowing cable systems to recover their capital costs plus an appropriate return with respect to the basic tier, they will have the opportunity to benefit from investment in improvements. With any new investment cable systems will also benefit in providing other such services they offer (e.g., expanded basic, pay services, pay-per-view services). With all these areas where cable systems will enjoy returns there will continue to be sufficient incentives for cable systems to invest and improve their facilities.

B. Description of NAB's Proposal

Under NAB's proposal for rate regulation the capital costs component of the basic tier rate will be calculated by the municipality with an easy-to-administer formula derived by the Commission.[19] The Commission would provide a formula

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[18](...continued)
those rules required by the Act. Whatever possible quality degradation not covered by these actions, if any, will be prevented by the suggested rate regulatory scheme.

[19] The Commission may decide to solicit cost information from a sample of cable systems, or alternatively obtain information from experts in the field of constructing cable systems. All the Commission needs to determine is the (continued...)

that would estimate the *replacement* capital costs for a cable system that would depend upon a number of relevant technical factors (e.g., number of miles provided, number of channels offered, etc.). The use of replacement costs as opposed to original costs is essential to the success of the proposal in order to achieve efficiency in administration, and, as will be discussed later, to avoid incorporating any monopoly rents into the calculation of the basic tier rates.

The local municipality will only need to obtain, if it does not already have it, the most summary type of information from the cable system such as the number of cable miles installed, type of equipment, number of channels, and age of the system, etc. The municipality will then input that information into the Commission-determined formula to derive the capital costs component of their system's basic tier rates.

Only a portion of, rather than the full capital costs will be included in the determination of the basic tier rates. The most appropriate method of apportioning those costs is to use the fraction of the number of basic tier channels divided by the total number of channels being offered on all tiers. Clearly the non-basic tier channels benefit from the capital investment and should "shoulder" some of those costs.[20/]

[19/](...continued)
actual capital costs of constructing cable systems, information that would be easily attainable from a number of sources.

[20/] In fact, by using the ratio of channels offered on the basic tier divided by the total number of channels offered, the proposal may be overly generous to the cable systems. The other channels will undoubtedly generate greater revenues, and thus, benefit more from the physical capital and other expenses incurred.
(continued...)

The other area of costs, non-capital costs, that are included in the rate formula fall into two categories, program licensing fees for the basic tier and other expenses. The program licensing fees component is straightforward as it includes any payments to services that are included in the basic tier. The Act indicates that these costs should be accounted for in the basic tier rate.[21] The other expenses category would include customer service expenses as well as any other expenses associated with running cable systems. These other expenses would also be apportioned in the basic tier rate calculation by the same fraction of the number of basic tier channels divided by the total number of channels being offered on all tiers. Once again, this is an appropriate allocation as the other channels benefit from these expenses being incurred.

With these three cost categories (allocated capital costs, program license costs, and allocated other expenses), the municipality need only to divide their total by the number of subscribers to determine the basic tier rate. For administrative ease, historical costs should be used, even though a short lag (preferably no more than one year) will result.

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[20](...continued)
Moreover, the Conference Report suggested that the Commission might allocate *less* than a proportionate share of capital costs to the basic tier. *Conference Report* at 63. In order to keep the formula simple to administer, however, it seems appropriate to allocate these costs by this ratio.

[21] Section 623(b)(2)(C)(ii).

C. Advantages of NAB's Proposed Rate Regulatory Scheme

In addition to the advantages already discussed, namely ease of application and prevention of quality degradation in the short and long runs, there are several other advantages to NAB's proposed rate regulatory scheme. First, and foremost, it eliminates cable's ability to continue to extract monopoly rents that would occur under alternative schemes. As a result, one of the most important objectives of the Act, lower prices for the basic tier of services, will be realized. For example, in Appendix A, SPR estimates that a minimal basic tier (16 channels out of a total 40 channel system) would, on average, under its formula cost $4.52.[22/]

In contrast, alternative suggested rate based benchmarks, using either the pre-1987 rates or present rates, fail to eliminate the monopoly overcharges that were Congress' core concern in adopting cable rate regulation legislation. The NAB proposed regulatory benchmark scheme does not suffer from this failing as it allows recovery of only the appropriate level of replacement costs in the basic tier rate.[23/]

22/ Using cost data from four MSOs, the prices for this basic tier service, under the SPR formula, range from $3.48 to $7.35, with a weighted (by the number of total subscribers) average of $4.52. While these calculations are preliminary (the Commission and municipality will have better data) these results suggest that there still would be some monopoly overcharge even with TCI's proposed new "bare bones" basic service rate of $10.00.

23/ As mentioned earlier, replacement capital costs are to be included in the calculation of basic tier rates. Using original costs for systems that were purchased with the expectation of continued monopoly power would only perpetuate the monopoly overcharges contrary to the mandate of the Act. "Use of data infected by the presence of monopoly rents to estimate legitimately recoverable capital costs [when using original costs] would permit operators to charge monopoly rates and, thereby, evade the intent of the statute." Appendix A at p. 8.

A second advantage of NAB's approach is that it continues to provide an incentive for providing a basic tier that would not be "stripped-down" to include only those services required by the Act. Cable systems will be able to recover any additional programming costs incurred by offering additional channels. They will also be able to allocate a larger portion of their capital costs (and an appropriate return on those costs) to the basic tier if more channels are included. Finally, the cable system would benefit in generating additional advertising revenues from those channels included in the more extensively subscribed (relative to the other tiers) basic tier. Overall, it would be left up to the cable operator to decide which channels to include in this basic tier.[24/]

A third advantage of NAB's approach is that the Commission would be confident of obtaining enough information to have a fully comprehensive rate scheme to offer to municipalities. In other proposed schemes, most noticeably the effectively competitive system rate benchmark scheme, the Commission will be unable to obtain an adequate amount of data through its proposed annual report of cable television systems, because there are not enough systems that meet this definition. No such problem exists with NAB's approach. There will be sufficient data for the Commission to generate the equation for the capital cost benchmarks and include the many

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24/ The Commission was concerned about the impact on cable system's incentives to continue investing in programming in a basic tier. *Notice* at ¶ 32. With the NAB proposed rate regulatory scheme, cable systems will continue to have incentives to invest in that programming.

variables that may affect these costs as listed by the Commission as necessary in the *Notice* ¶ 42.[25]

A final advantage of the NAB basic rate proposal is that the calculation of the rates would not over time be distorted by the fact that rates are being regulated. The Commission recognizes that an alternative proposal, the average rate benchmark scheme, "would be affected by regulation and would cease to be an independent measure of industry performance." *Notice* ¶ 47. Since the foundations of NAB's scheme, the capital and non-capital costs, are determined independently of the method in which rates are established, it does not suffer from this failing.

One concern that may be raised with NAB's proposal is the potential it provides, particularly for vertically integrated cable operator-programmers, to raise the prices of their programming, which could then be recovered by their cable systems, as a means of circumventing the limitations imposed by the capital cost allocation provisions of NAB's proposal. To avoid this possibility the Commission should require appropriate reporting requirements that would enable it to detect any unjustified anomalies in cable program pricing by vertically integrated companies, and

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25/ A related advantage for the NAB proposed regulatory scheme is the flexibility it provides to change over time. The Commission in the *Notice* ¶ 34 recognizes the importance of this flexibility. The NAB proposed regulatory scheme, most importantly in the calculation of the capital cost estimating equation, can adapt to changes in the cable industry by using the already collected yearly cost information.